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IN THE

Supreme Court of the United States

OCTOBER TERM, 1967

No. 1014

FEDERAL OIL COMPANY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

MARTIN D. COHEN,
Attorney for Petitioner,
744 Broad Street,
Newark, New Jersey, 07102.

COHEN, ROSENBAUM & SCHER,
Of Counsel.

Adams Press Corp., 11 Commerce Street, Newark, N. J.—Market 3-8611-12

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IN THE

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FEDERAL OIL COMPANY,

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v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

Petitioner by its counsel, prays that a writ of certiorari issue to review the judgment rendered below in this case by the Court of Appeals for the Third Circuit.

Opinions Below

The memorandum findings of fact and opinion of the Tax Court of the United States was filed August 31, 1966, and has been designated as "T.C. Memo. 1966-195." (Ap-

pendix C, *infra,* pp. 4a-22a). The *per curiam* opinion of the Court of Appeals (Appendix A, *infra,* pp. 1a-2a), was filed September 27, 1967, but is not yet reported.

Jurisdiction

The judgment of the Court of Appeals was entered September 27, 1967. By order of Mr. Justice Brennan, dated December 21, 1967 (Appendix D, *infra,* p. 23a), the time for filing a petition for a writ of certiorari has been extended until January 12, 1968. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

Questions Presented

1. Where a taxpayer offers strong proof that a written agreement, although not the product of fraud, duress, mistake or undue influence, nevertheless fails to reflect the substance or true nature of the underlying transaction, should the writing be determinative of the tax consequences?

2. In the trial of a case before the Tax Court, is the applicability of the "stranger" exception to the "parole evidence rule" a matter whose resolution is governed by the rules of evidence applicable in trials without a jury in the United States District Court of the District of Columbia, pursuant to the provisions of 26 U.S.C. §7453?

3. If the applicability of the "stranger" exception to the "parole evidence rule" is subject to the provision of 26 U.S.C. §7453, did the court err by refusing to follow the rule adopted with respect thereto by the Court of Appeals for the District of Columbia?

4. Assuming, *arguendo,* that the "parole evidence rule" were otherwise applicable to tax litigation so as to preclude a party to a written agreement from challenging an

allocation of purchase price contained therein, does the rule apply even in cases where the Commissioner takes inconsistent positions and, thus, himself attacks the agreement?

Statute Involved

Internal Revenue Code of 1954:

Sec. 7453 RULES OF PRACTICE, PROCEDURE, AND EVIDENCE.

The proceedings of the Tax Court and its divisions shall be conducted in accordance with such rules of practice and procedure (other than rules of evidence) as the Tax Court may prescribe and in accordance with the rules of evidence applicable in trials without a jury in the United States District Court of the District of Columbia.

Statement of the Case

The taxpayer, Federal Oil Company, has been a wholesale gasoline distributor since 1937. (Appendix C, *infra*, p. 5a). In 1956, the taxpayer formed a wholy-owned subsidiary, Economy Service, Inc. (hereinafter, "Economy") for the purpose of engaging in the retail fuel oil business. In 1957, the taxpayer formed another wholly-owned subsidiary, Federal Economy Corporation to deliver fuel oil to Economy's customers. (Appendix C, *infra*, pp. 5a-6a). Michael Singer was president of all three corporations and principal stockholder of the taxpayer. His wife also owned some stock but was not active in the retail fuel oil business. (Appendix C, *infra*, p. 6a).

On February 27, 1959, the taxpayer, its subsidiaries, and Mr. and Mrs. Singer entered into a written agreement with Sinclair Refining Company (hereafter, "Sinclair") for the sale of Economy's retail fuel oil business, together with all physical assets related thereto, good will and the non-compete covenants of all vendors. The total purchase

price was $1,000,000. In the agreement, the amount of $640,000 (in the aggregate), was allocated to physical assets; $310,000 to the non-compete covenants; and $50,000 to good will (Appendix C, *infra,* pp. 11a-18a). Although the non-compete covenants were those of the taxpayer, its subsidiaries, Singer and Singer's wife, the written contract provided for the payment of $310,000 in five equal installments of $62,000 each, to the taxpayer alone. (Appendix C, *infra,* pp. 14a-15a, 17a).

The nature of the retail fuel oil business is such that customers, once acquired by a dealer, tend to remain its customers as long as good service is rendered. This is true notwithstanding successive changes in ownership of the dealer, as long as the transition is gradual. From 90 to 95 per cent of the retail accounts acquired by the taxpayer in 1952 and 1953 were still on the books of Economy at the time of the sale to Sinclair in 1959. For a time, Sinclair used Economy's billing system as well as the trucks of the taxpayer and its subsidiaries for the conduct of the acquired retail fuel oil business. (Appendix C, *infra,* p. 18a).

The volume of retail fuel oil sales made by Economy for the year preceding the sale to Sinclair, amounted to 12,000,000 gallons. (Appendix C, *infra.* p. 8a).

The retail accounts representing this 12,000,000 gallon annual sales volume had been acquired by the taxpayer in piecemeal fashion between 1952 and 1955. Customers representing aproximately 3,000,000 gallons of annual sales were acquired by the taxpayer in 1952 from a retail dealer known as Federal Petroleum Corporation (hereafter "Old Federal"). Although the contract of sale between the taxpayer and Old Federal made no allocation of purchase price to good will, the matter of the taxpayer's Federal income tax liability for 1953 was docketed in the Tax Court and ultimately settled by a stipulation which re-

quired the taxpayer to allocate the sum of $88,004.17 to the cost of acquiring the good will of Old Federal. (Appendix C, *infra,* pp. 6a-7a).

The Tax Court case also involved the allocation of the taxpayer's cost of acquiring the business of City Coal and Fuel Oil Co. (hereafter "City Coal") in 1953 and 1954 representing an annual volume of retail fuel oil sales of 2,000,000 gallons. The settlement of the Tax Court matter required the taxpayer to allocate a total of $26,427.85 to the cost of acquiring the good will of City Coal. (Appendix C, *infra.* p. 7a).

In 1955, the balance of the business which ultimately reached an annual volume of 12,000,000 gallons was acquired by the taxpayer from a corporation known as Economy Service Inc. (hereafter, "Old Economy"). The purchase involved the payment of $600,000 for Old Economy's physical assets and $250,000 to the individual stockholders of Old Economy for their stock.[1] (Appendix C, *infra,* pp. 7a-8a).

The written contract between the taxpayer and Sinclair had been preceeded by extensive negotiations including discussions of purchase price and the allocation to be made thereof to various assets (Appendix C, *infra,* pp. 9a-10a).

Singer was advised by representatives of Sinclair that it intended to amortize the amount allocated in the contract to the non-compete covenants. The taxpayer's accountant, however, advised Singer that in view of the taxpayer's previous experience in connection with the City Coal and

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[1] Inasmuch as the only other asset which Old Economy possessed in addition to its physical assets consisted of the good will attributable to its annual sales volume, it may reasonably be presumed that the $250,000 paid for the stock of Old Economy represented the value of such good will.

Old Federal acquisitions, the portion of the purchase price actually attributable to the good will being sold to Sinclair, which he considered substantial, would be taxable at capital gain rates, regardless of the allocation made in the contract. (Appendix C, *infra,* pp. 9a-10a).

The internal records of Sinclair, containing a detailed history of the negotiations leading up to the final contract, disclose that the amount which Sinclair proposed to pay, for a non-compete agreement, was calculated by use of a formula of so-many-cents-per-gallon times 12,000,000 gallons of annual sales. (Appendix C, *infra,* pp. 10a-11a).

The amount of $310,000 stated in the agreement to be for "non-compete covenants" was paid to the taxpayer in annual installments of $62,000 each, in the years 1959 to 1963, inclusive. On its returns for the years 1960 to 1963, inclusive, the taxpayer treated each such payment as long-term capital gain from the sale of good will. The Commissioner determined that the payments constituted ordinary income because they were received for a covenant not to compete. (Appendix C, *infra,* pp. 18a-19a).

On its income tax returns for each of the taxable years, 1959 to 1963, Sinclair deducted as an expense the $62,000 payment made to the taxpayer, treating each such payment as consideration for the non-compete covenants.

Pending the outcome of this case, the Commissioner tentatively questioned Sinclair's treatment of the payments. The audit of Sinclair's returns for the years in question has been held in suspense pending further action. (Appendix C, *infra,* p. 19a).

Before the Tax Court, the taxpayer contended that although the written agreement contained an allocation of $310,000 to non-compete covenants and $50,000 to good will, in reality the aggregate of these two amounts, that is,

$360,000 represented the value of Economy's good will as a going business; that such good will consisted of the probability that Sinclair would retain the accounts it acquired, as had been the taxpayers experience with respect to the accounts it had acquired from others in 1952 and 1953; that a formula, namely, $.03 per gallon times 12,000,000 gallons, was used to arrive at the true value of Economy's good will; that Singer was no competitive threat because his very reason for wishing to sell to Sinclair was his desire to get out of the retail fuel oil business; and finally that Sinclair's insistence that a large amount be allocated to covenants not to compete, notwithstanding the true nature of the payment involved, was tax motivated.

Notwithstanding Sinclair's admitted tax motivation and other evidence tending to show that the $310,000 allocated to non-compete covenants was economically unrealistic, the Tax Court determined it could not look behind the written contract because it had been negotiated at arm's length.

Reasons for Granting the Writ

I.

As noted in the court's *per curiam* opinion, the taxpayer challenged the allocation contained in its written agreement with Sinclair on the ground "that it does not accord with the economic reality of the transaction." (Appendix A, *infra,* p. 2a). The court declined to consider the taxpayer's challenge on its merits, declaring the case to be controlled by the recent decision in *Commissioner* v. *Danielson,* 378 F. 2d 771 (C. A. 3d Cir. 1967), *certiorari* denied, October 9, 1967, wherein the court adopted the following rule:

> "A party can challenge the tax consequences of his agreement, as construed by the Commissioner, only by adducing proof which, in an action between the parties to the agreement, would be admissible to alter that construction or to show its unenforceability because of mistake, undue influence, fraud, duress, etc." *Commissioner* v. *Danielson, supra,* 775.

Because most other authorities hold that "parole evidence" *is* admissible in federal tax litigation, *Danielson* has had the sort of "bombshell" effect attributed to the celebrated case of *May* v. *Heiner,* 281 U. S. 238 (1930).[2] Indeed, the weight of authority which directly conflicts with the Third Circuit's newly adopted rule is staggering.

4 *Williston, Contracts* §647 (3d Edition) states the prevailing view as follows:

> The courts . . . in accordance with the great weight of authority[4] [Citations omitted] hold that the rule applies only in controversies between parties to the instrument and those claiming under them . . . Here, the United States was a stranger to the contract. It asserts a tax liability, not a claim derived from either party to the contract, and *it* could not invoke the parole evidence rule.[5] [Citing *American Crystal Sugar Co.* v. *Nicholas,* 124 F. 2d, 477 (C. C. A. 10); italics supplied]

To the same effect are 34 Am. Jur. 2d §9319 (1968); 30 Am. Jur. §1031; 9 *Mertens, Law of Federal Income Taxa-*

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[2] Cf. 74 Cong. Rec. 7078 (1931). Counsel for *Danielson* report having received requests for briefs from over twenty law reviews (including those of Yale, Harvard, Columbia and Virginia), each indicating that because of the unusual result of the case, it is contemplated that a note or article is to be written.

tion §50.80; "When You Go To The Tax Court—Procedure and Practice" ¶325 (Commerce Clearing House); 32A C. J. S. Evidence, §861.

The Tax Court and the courts of appeals of virtually every circuit have consistently held, over a long period of years, that the parole evidence rule does not apply in tax litigation and that either the Commissioner or a party to a written agreement may offer evidence to show that the formal terms of a written contract do not truly reflect the essential nature of the underlying transaction. This liberal rule is as old as the Tax Court's predecessor, the Board of Tax Appeals. *Converse & Co.*, 1 B.T.A. 742, 745 (1925); it was reiterated by the Tax Court in *Haverty Realty & Investment Co.*, 3 T.C. 161, 167 (1944); and has been followed in scores of later Tax Court decisions, the most recent being *Peerless Steel Equipment Co.*, T.C. Memo. 1967-181 (decided September 11, 1967).

Recent holdings of other courts to the effect that the parole evidence rule may not be invoked *by the Commissioner* against a taxpayer include *Landa* v. *Commissioner*, 211 F. 2d 46 (C.A.D.C. Cir. 1954); *Scofield* v. *Greer*, 185 F. 2d 551, 552 (C.A. 5th Cir. 1950); *Builders Steel Co.* v. *Commissioner*, 179 F. 2d 377, 379 (C.A. 8th Cir. 1950); *Thornsness* v. *U. S.*, 260 F. 2d 341 (C.A. 7th Cir. 1958); *Riddell* v. *Guggenheim*, 281 F. 2d 836 (C.A. 9th Cir. 1960); and *Mustard* v. *United States*, 155 F. Supp. 325, 332 (Ct. Cl. 1957).

Neither in spirit nor in principle can the newly adopted rule of the Third Circuit be reconciled with the pronouncement of this Court in *Helvering* v. *F. & R. Lazurus & Co.*, 308 U. S. 252 (1939), that "in the field of taxation, administrators of the laws, and the courts, are concerned with substance and realities, and formal written documents are not rigidly binding." In *Helvering* v. *F. & R. Lazurus & Co.*, *supra*, as well as in *Helvering* v. *Tex-Penn Oil Co.*, 300

U. S. 481 (1937) and *Bartels* v. *Birmingham*, 32 U. S. 126 (1947), it was the taxpayer who successfully attacked a formal written agreement into which he had entered.

We acknowledge that *strong proof* must be adduced by a taxpayer in order to overcome the presumption that the allocations in a written contract are to be taken at face value. *Ullman* v. *Commissioner*, 264 F. 2d 305, 308 (C.A. 2d Cir. 1959). That is a far cry from a requirement that fraud, duress, undue influence or mistake be established in order to avert the exaltation of form over substance. *Cf. Helvering* v. *F. & R. Lazurus & Co., supra.*

As pointed out under II, *infra,* although there may have been bases for denying the writ applied for in *Danielson* v. *Commissioner, supra,* this case is free of the same limitations.

Because of the acknowledged frequency with which cases of this genre arise, and the very apparent conflict between the newly adopted *Danielson* rule and the contrary weight of authority as cited above, it is highly desirable that this Court resolve the conflict now.

Indeed, there is fresh evidence that the question involved will continue to plague taxpayers, the Commissioner and the courts until it is resolved by this Court. The ink on the *Danielson* decision was scarcely dry when the Tax Court, in an able opinion by Judge Simpson, made it clear it can not live with the rule laid down by the Third Circuit. In *Peerless Steel Equipment Co.,* T.C. Memo 1967-181 (decided September 11, 1967) a case involving a Philadelphia, Pennsylvania corporation which, in the event of appeal, would come before the Third Circuit, the Tax Court, while noting the Third Circuit opinion in *Danielson,* nevertheless held that "when there is strong proof, the substance of the transaction governs the tax consequences." The taxpayer was found to have met its burden although neither fraud or anything of the like was shown.

II.

Bearing in mind this Court's traditional practice of not specifying grounds for the denial of a petition for a writ of certiorari, but considering also the apparent and substantial need for resolution of the conflict created by *Commissioner* v. *Danielson, supra,* we have presumed to speculate as to the Court's rationale in denying the writ in *Danielson,* in order to point out that the status of the instant case is distinguishable.

Although *Danielson* expresses the necessity of establishing fraud, undue influence, duress or the like in order to overcome the allocations of purchase price contained in a written contract, the case was remanded to the Tax Court to enable the taxpayer to offer such proof. In that posture, it may well have been thought premature to review the case here.

In the instant case, unlike *Danielson,* the opportunity to offer proof on remand was not granted by the court. With all other roads closed, it is imperative to grant the writ herein so that the question thus squarely presented may be resolved by this Court.

As found by the Tax Court, the Commissioner not only determined deficiencies against the taxpayer, but he also challenged the right of Sinclair to treat the amounts paid to the taxpayer as amortizable payments for non-compete covenants. In essence, insofar as Sinclair's tax liability is concerned, the Commissioner tentatively attacked the written agreement. Thus, if Sinclair's case had gone through the administrative stages and into litigation before the instant case, there would be no question about the Commissioner's right to attack the allocation made to non-compete covenants in the written contract. The fortuitous circumstances which determine which of two cases, representing opposite sides of the same coin, reaches litigation

first, should not control the ultimate question of whether or not the declarations of a written agreement are determinative of the tax consequences of the underlying transaction.

The inequitable aspects of the matter are further compounded by the common practice, where the Commissioner takes inconsistent positions, of consolidating for trial the cases of all taxpayers thereby affected. Then, there is no question but that the courts *will* accept oral testimony to the effect that the true transaction differed from that spelled out in the contract. *Lacy* v. *Commissioner,* 341 F. 2d 54 (C.A. 10th Cir. 1965) *Ray H. Schultz,* 34 T.C. 235 (1960), aff'd, 294 F. 2d 52 (C.A. 9th Cir. 1961). A taxpayer should not be denied an equal opportunity to prove that a formal writing is lacking in substance or reality, merely because a related case is being held in suspense administratively, as here, and therefore cannot be consolidated for trial.

The anomalous situations thus created when the Commissioner takes inconsistent positions in cases such as this were apparently not pointed out to court in *Commissioner* v. *Danielson, supra.* In any event, the matter was neither referred to nor considered by the court in its opinion. This very significant factor and the desirability of examining more closely the extent of the inequities potentially flowing therefrom warrant granting the writ herein.

III.

Section 7453[3] requires that trials in the Tax Court be conducted "in accordance with the rules of evidence applicable in trials without a jury in the United States District Court ofthe District of Columbia."

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[3] All statutory references herein are to the Internal Revenue Code of 1954 (26 U.S.C.). The text of Section 7453 has been set out under "Statute Involved" *supra,* at page 3.

As noted in the dissent of Chief Judge Staley, in *Commissioner* v. *Danielson, supra,* the legislative history of Section 7453 shows very clearly that Congress intended the Tax Court to be as liberal as possible in the reception of evidence on issues presented to it.[4] *Id.*, at 781.

Landa v. *Commisisoner, supra,* a case decided by the Court of Appeals for the District of Columbia Circuit, while involving a different issue of substantive law, squarely presented the question of whether a party will be permitted to impugn his own contract in order to show that the tax consequences thereof should be different than the formal provisions of the contract would indicate.

The District of Columbia Circuit, finding the taxpayer's testimony more consistent with the realities of the situation than the characterization of certain payments as set forth in the written agreement, expressed its *ratio decidendi* as follows:

> * * * it might be urged that the parties should be bound by their own device. While acceptance of this argument is tempting, we think its rejection compelled by the rule that "[in] the field of taxation, administrators of the laws and the courts are concerned with substance and realities, and formal written documents are not rigidly binding." The purpose of this rule is manifest. Whenever taxa-

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[4] As originally enacted, this provision referred to rules of evidence applicable to equity courts of the District of Columbia. 44 Stat. 107 (1926). Its purpose appears plainly from the comment in 1925 of Chairman Green of the House Ways and Means Committee: ". . . . [T]here can be no broader rule than in equity cases as it admits everything that will affect the results." 67 Cong. Rec. 1143 (1925). The present wording merely conforms to the procedural merger of law and equity. 1954 U. S. Code Cong. and Adm. News 4581.

> tion is allowed to depend upon form, rather than substance, the door is opened wide to distortions of the tax laws which, after all, represent the legislative judgment for an equitable distribution of the tax burden generally. Clearly, this purpose is not advanced by applying the rule only if it serves to increase the tax in a particular case. "The Taxpayer as well as the Commissioner of Internal Revenue is entitled to the benefit of this rule." *Landa* v. *Commissioner, supra,* 50 [Footnotes omitted].

While it cannot be gainsaid that the parole evidence rule, according to the prevailing modern view, is a rule of substantive law, 4 *Williston, Contracts* §631 (3d Edition-Jaeger), it is submited that the "stranger exception" to the rule does not involve substantive law but is a rule of evidence; therefore, the Third Circuit erred in failing to follow *Landa* v. *Commissioner, supra,* as the controlling rule of evidence applicable in the District of Columbia pursuant to the mandate of Section 7453.

The reasoning in support of the view that the parole evidence rule is one of substantive law, is that when parties reach an agreement which has become integrated in the form of a written document, the substantive rights between the parties *inter sese* have been established. Oral evidence, therefore, should not be permitted in derogation of the substantive rights thus established. 4 *Williston, Contracts supra,* § 631.

On the other hand, a written agreement creates no substantive rights as between a contracting party and a stranger in no way privy thereto. It is for this very reason that the parole evidence rule is almost universally held not to apply in controversies between a contracting party and a stranger, so that either may offer to prove that the writ-

ing is not a true reflection of the underlying transaction. This is because no substantive rights are affected. It follows that the exclusion or admission of such proof calls for a ruling on evidence and not one of substantive law.

The affirmance of the Tax Court's decision herein, based solely on the taxpayer's failure to offer proof that the contract between it and Sinclair was tainted by fraud, duress, undue influence, or the like, is tantamount to a ruling rejecting all other evidence offered by the taxpayer as irrelevant. Specifically, under such ruling, no consideration is to be given to proof that the allocation of $310,000 to non-compete covenants grossly distorted the true nature of the payment. And yet the evidence overwhelmingly establishes Sinclair's recognition of the fact that it was purchasing valuable good will because of the established probability that Economy's customers would continue to patronize Sinclair following transfer of the business. Not only was this good will in its most elemental form,[5] but the very formula (3 cents per gallon times 12,000,000 gallons) used to arrive at the amount to be paid for intangible assets (good will and non-compete covenants) constitutes irrefutable, mute evidence that in actual fact good will alone was the item being valued.

In excluding such evidence from consideration, a rule of evidence and not a rule of substantive law was applied. Whether or not the court ignored the mandate of Section

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[5] When the taxpayer purchased some of these very accounts from Old Federal and from City Coal, it had been required to treat its cost as non-amortizable good will. In the case of accounts acquired from Old Federal, representing 3,000,000 gallons of annual sales, the Tax Court settlement required the taxpayer to allocate approximately $88,000 to good will. This amounted to 2.9 cents per gallon, virtually the same formula for valuing *good will* as was used by Sinclair! (App. pp. 6a-7a)

7453 by failing to follow *Landa* v. *Commissioner, supra,* a precedent which clearly and authoritatively ennunciates the rule of evidence to be applied in the premises, is at the very least, a question of vital importance which has not been but should be resolved by this Court.

IV.

The most shocking and incomprehensible aspect of *Commisioner* v. *Danielson, supra,* held to be controlling herein, is that the majority opinion contains, literally, an invitation to taxpayers to traffic in tax benefits; for its states, "the presumed tax consequences of the transaction may, as here, help to determine the total amount a purchaser is willing to pay for such a purchase. Therefore, to permit a party to an agreement fixing an explicit amount for the covenant not to compete to attack that provision for tax purposes * * * would encourage parties unjustifiably to risk litigation after consummation of a transaction in order to avoid the tax consequences of their agreements. * * * The buyer would be forced to defend the agreement in order to amortize the amount allocated to the covenant. If unsuccessful, the buyer would lose *a tax advantage it had paid the selling-taxpayers to acquire.* In the future, buyers would be unwilling to pay sellers for tax savings so unlikely to materialize." (emphasis supplied) *Id,* at 775.

The Third Circuit majority felt it would be salutary to adopt a rule requiring taxpayers who trade in tax advantages to be held to their bargains. Otherwise, the court felt, a dilemma confronts the Commissioner if taxpayers are free to ignore their contracts for tax purposes. *Id,* at 775.

A more salutary, and certainly an equally valid rule is advocated by the taxpayer, namely, that a formal writing should not be permittted to control tax conseqences when

strong proof is offered to show that the formal trappings are nothing but a masquerade for tax-motivated purposes. The latter rule would discourage trafficking in tax advantages. For under it, taxpayers will be more prone to enter into contracts which accurately reflect their transactions; and negotiations purely for tax advantages will be held to a minimum. Moreover, such a rule is consistent with what has always been the philosophy of this Court, that "questions of taxation must be determined by viewing what was actually done, rather than the declared purpose of the participants; and when applying the provisions of the Sixteenth Amendment and income laws enacted thereunder we must regard matters of substance and not mere form." *Weiss* v. *Stearn*, 265 U. S. 242, 254 (1924); *Helvering* v. *Tex-Penn Oil Co., supra; Helvering* v. *F. & R. Lazurus & Co., supra*, 255; *Bartels* v. *Birmingham, supra*, 129.

Nor has Congress ever evinced a willingness to condone trafficking in tax advantages; otherwise, what earthly reason or rationale could there be for the enactment of such anti-tax avoidance provisions as sections 267, 269, 306, 382 or 1551?

It is one thing to say that in the absence of fraud, duress, undue influence or the like, the courts should leave contracting parties to their devices. It is another thing to say that no matter how the parties to a contract have distorted the economic realities of the underlying transaction, courts having jurisdiction over tax controversies will blind themselves to such distortion if the facts are brought to the court's attention by a contracting party rather than by the Commissioner of Internal Revenue. Not only is such a double standard odious and out of harmony with the equitable administration of the tax laws, it fails utterly, as noted above, to have the salutary effect which the court below would ascribe to it. It is of vital importance for

this Court to determine, at this time, whether the implication of *Commissioner* v. *Danielson, supra,* 775, that trafficking in tax advantages is not only condoned by the courts but will be protected against attacks on the part of a bargaining party, represents the law.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted in this case.

Respectfully submitted,

MARTIN D. COHEN
Attorney for Petitioner

Dated: January 12, 1968

APPENDIX A

Opinion of the Court

(Filed—September 27, 1967)

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 16326

FEDERAL OIL COMPANY,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

Argued April 20, 1967

Before SMITH and FREEDMAN, *Circuit Judges* and WORTENDYKE, *District Judge*

PER CURIAM.

The taxpayer, a wholesale gasoline and retail fuel oil distributor, sold its fuel oil business to Sinclair Refining

Company under a contract which allocated a substantial amount of the purchase price to taxpayer's five year covenane not to compete. The Commissioner and the Tax Court accepted this allocation and taxed yearly payments made pursuant thereto as ordinary income. If the allocation is accepted this is admittedly the appropriate tax treatment. Taxpayer, however, challenges the allocation on the ground that it does not accord with the economic reality of the transaction. It urges that the allocation to the covenant was in fact for good will and should be taxed as long term capital gain.

In Commissioner of Internal Revenue v. Danielson, 378 F. 2d 771, 775 (3rd Cir. 1967), this Court, sitting en banc, adopted the following rule: "[A] party can challenge the tax consequences of his agreement as construed by the Commissioner only by adducing proof which in an action between the parties to the agreement would be admissible to alter that construction or to show its unenforceability because of mistake, undue influence, fraud, duress, etc." No such proof has been offered or adduced in the instant case.

The decision of the Tax Court will be affirmed.

A True Copy:

Teste:

Clerk of the United States Court
of Appeals for the Third Circuit

APPENDIX B

Judgment

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 16326

FEDERAL OIL COMPANY,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

C.T.C. DOCKET No. 54466-64

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

Present:

SMITH and FREEDMAN, *Circuit Judges,* and WORTENDYKE, *District Judge.*

This cause came on to be heard on the record from the Tax Court of the United States, and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged and decreed by this Court that the decision of the said Tax Court in this cause be, and the same is hereby affirmed.

September 27, 1967

ATTEST:

THOMAS F. QUINN
Clerk

APPENDIX C

Memorandum, Findings of Fact and Opinion of the Tax Court of the United States

T. C. Memo. 1966-195

TAX COURT OF THE UNITED STATES

FEDERAL OIL COMPANY,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket No. 5466-64. Filed August 31, 1966.

Held: Certain payments made to petitioner by Sinclair Refining Company in the taxable years involved pursuant to an agreement for the sale of a retail fuel oil business were payments made in consideration of a covenant not to compete and not for the sale of goodwill.

Martin D. Cohen, for the petitioner.

Donald H. Cuozzo and *William M. Gross,* for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

BRUCE, *Judge*: Respondent determined deficiencies in the income taxes of petitioner for the years 1960, 1961, and 1962 in the amounts of $16,739.74, $16,740, and $17,897.97,

respectively. The sole issue is whether payments in the amount of $62,000 made to petitioner by Sinclair Refining Company in each of the years 1960, 1961, and 1962 were in consideration of a covenant not to compete or for the sale of goodwill.

Findings of Fact

Some of the facts have been stipulated. The stipulation of facts and exhibits attached thereto are incorporated herein by reference.

Petitioner is a New Jersey corporation organized on June 18, 1937, as Federal Petroleum Corporation, with its principal office at 525 Raymond Boulevard, Newark, New Jersey. It maintains its books and records on a calendar year and accrual basis, and filed its Federal income tax returns for 1960, 1961, and 1962 with the district director of internal revenue at Newark, New Jersey. Petitioner at all times has been a wholesale distributor of gasoline and other petroleum products, selling to service stations located in Essex County, New Jersey, under a distributorship contract with American Oil Company. In addition to its wholesale distributor business, petitioner had approximately 80 retail fuel oil customers in November 1952.

Federal Economy Corporation (hereinafter referred to as Federal) and Economy Service, Inc. (hereinafter referred to as Economy), were New Jersey corporations organized on January 1, 1957, and January 5, 1956, respectively, with principal offices in Newark, New Jersey, at 525 and 523 Raymond Boulevard, respectively. Petitioner owned 100 percent of the stock of each corporation from the date of its incorporation until its dissolution on June 30, 1959. While in existence, Economy was a retail dealer

in fuel oil which sold and serviced oil burners, and Federal was engaged in the business of delivering fuel oil to Economy's customers. At all material times, petitioner, Economy and Federal each filed separate Federal income tax returns and not consolidated returns.

Michael and Sydel Singer are husband and while who reside in New York, New York. In 1958 Michael owned 66-2/3 percent of the outstanding stock of petitioner. At all times material herein, he was president of petitioner and was president of both Economy and Federal during their corporate existence. Sydel was a substantial stockholder in petitioner and was assistant vice president of petitioner, Economy, and Federal but was not active in the management of the retail fuel oil business.

In November 1952 petitioner, then still known as Federal Petroleum Corporation, purchased all of the outstanding stock of an unrelated New Jersey corporation known as Federal Oil Company of Union, New Jersey (hereinafter referred to as Old Federal). At the time of the stock purchase, Old Federal had approximately 1,525 retail fuel oil customers and was engaged in the business of selling retail fuel oil to customers consisting of private homes, industrial plants and apartment houses, as well as oil burner sales and service. The average gallonage of fuel oil sold by Old Federal to retail customers was approximately three million gallons annually. The total purchase price for this acquisition by petitioner was $118,652.43. From November 1952 until December 31, 1953, Old Federal was operated as a wholly-owned subsidiary of petitioner. On January 1, 1954, Old Federal was merged into petitioner, which thereupon changed its name to Federal Oil Company, by which name it has been known at all times since.

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Upon examination of petitioner's Federal income tax returns for the retaxable years 1953 and 1954, respondent determined that petitioner had not correctly allocated its cost of acquiring Old Federal to the various assets acquired through the purchase. A deficiency notice was issued to petitioner for the taxable year 1953 and petitioner thereafter filed a petition with this Court for redetermination of the deficiency. The case was ultimately settled by stipulation of the parties and pursuant to the settlement petitioner was required to allocate, and did in fact allocate, on its books of account the sum of $88,004.17 to the cost of acquiring the goodwill of Old Federal.

On December 7, 1953, petitioner acquired all of the retail fuel oil and oil burner service and sales customers of City Coal and Fuel Oil Co., Inc., of Newark, New Jersey, a New Jersey corporation (hereinafter referred to as City Coal). Prior to such acquisition, the annual volume of retail fuel oil sales made by City Coal was approximately two million gallons. The only other asset which petitioner acquired from City Coal, apart from its retail account, was an oil truck. In connection with the settlement of petitioner's Federal income tax liabilities for 1953 and 1954, petitioner was required to allocate and did allocate on its books for 1953 and 1954 the amount of $10,044.33 and $16,383.52, respectively, as the cost of acquiring the goodwill of City Coal.

In December 1955, petitioner contracted with Emil and Rita Miller to purchase all of the stock of Economy Service, Inc. (hereinafter referred to as Old Economy), a corporation engaged in the retail fuel oil and oil burner service and sales business, and the physical assets, also owned by the Millers, used by Old Economy in the conduct of its business, consisting of land and buildings located at 515-

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527 (rear) and 515-525 (front) Raymond Boulevard in Newark, New Jersey, and certain oil storage tanks and other related facilities. The purchase price was $250,000 for the stock and $600,000 for the physical assets. Petitioner acquired these assets in January 1956, which were placed on its books as follows:

Land	$251,000
Garage building (office)	62,500
Factory building and garage	137,500
Tanks, dock, pump-house and yard equipment	149,000
Total	$600,000

Simultaneously with the acquisition of the stock, petitioner caused Old Economy to be liquidated and dissolved.

Petitioner momentarily held the assets of Old Economy until it organized Economy on January 5, 1956, and acquired all of its stock in exchange for the transfer to Economy of these assets along with all of its other retail fuel oil and oil burner service and sales business, including all of its retail customers. All of the retail fuel oil and oil burner installation and service business previously conducted by petitioner was handled by Economy after January 5, 1956. Petitioner did not directly engage in the retail fuel oil business after the formation of Economy during the period from January 5, 1956, through February 27, 1959. During the fiscal year May 1, 1957, to April 30, 1958, Economy made retail fuel oil sales of approximately 12 million gallons.

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Journal entries on Economy's books under date of December 31, 1958, reflect a liability owing by Economy to petitioner in the amount of $88,004.17 and $10,044.33, respectively representing petitioner's cost in acquiring the goodwill of Old Federal and City Coal. A journal entry of March 31, 1959, reflects an additional liability for the cost of the goodwill of City Coal in the amount of $16,383.52. Petitioner's books of account contain corresponding journal entries.

In approximately October 1958, Singer entered into negotiations on behalf of petitioner, Economy and Federal, with the Sinclair Refining Company (hereinafter referred to as Sinclair), a Maine corporation, with respect to the sale of the retail fuel oil business conducted by Economy and Federal. B. P. Mackenzie, a division manager for Sinclair, who was deceased at the time of the trial, represented Sinclair in the negotiations.

During the course of these negotiations, which consisted of many conferences, Singer and Mackenzie discussed the specific amounts to be paid for each group of tangible assets, including the amounts to be paid for goodwill and for a covenant not to compete. Mackenzie informed Singer that Sinclair would deduct as a business expense the amounts paid for the covenant not to compete, and at a meeting attended by Singer's tax advisor and Jim Patterson, Sinclair's tax manager, the parties discussed the fact that the sale of goodwill would be capital gains to the seller and the amounts received by the seller for a covenant not to compete would be ordinary income. Singer's certified public accountant, William Lax, advised Singer that it was his opinion, based upon respondent's allocation of part of the amount paid by petitioner for the assets of old Fed-

eral and City Coal to goodwill, that the portion of the purchase price actually attributable to the goodwill sold, which he considered substantial, would be taxable at capital gain rates, regardless of the allocation made in the contract.

Before a contract was executed, the proposed acquisition was reviewed and passed upon by a succession of officials at various echelons in the management of Sinclair. In a report to Mackenzie dated November 5, 1958, H. R. Barley, Sinclair's district manager for New Jersey who had attended some of the conferences between Singer and Mackenzie, stated that Singer was willing to sell the business for $578,500 for the physical assets plus a payment for a 10-year noncompete agreement equal to four cents per gallon, or approximately $480,000, based on current volumes of twelve million gallons annually. Barley's report, together with Mackenzie's comments, were submitted to Sinclair's budget committee which recommended to Sinclair's executive committee in a report dated January 16, 1959, that Sinclair pay not more than one million dollars, exclusive of inventory, allocated: $500,000 to physical assets; $50,000 to goodwill; and $450,000 to an agreement not to compete, computed on the basis of 3.75 cents per gallon on an estimated volume of twelve million gallons. Sinclair's executive committee approved the purchase on the basis of this report on January 22, 1959, and the purcase was approved by Sinclair's parent corporation, Sinclair Oil Corporation (hereinafter referred to as Sinclair Oil), on this basis on approximately January 30, 1959. Subsequent to final approval of the purchase by Sinclair Oil on the basis of Sinclair's budget committee's recommendation, two changes were made, upon Singer's instigation, in the allocation of the purchase price to basic asset groups. On approximately February 4, 1959, Sinclair

agreed to the purchase on the basis of $590,000 for physical assets, $50,000 for goodwill, and $360,000 for a non-compete agreement, computed at 3 cents per gallon on a sales volume of twelve million gallons. The final allocation of $640,000 to physical assets, $50,000 to goodwill, and $310,000 to the covenant not to compete was approved on approximately February 16, 1959. One of Sinclair's representatives showed Singer a copy of the final draft of the agreement prior to the execution date and discussed it with him.

On February 27, 1959, petitioner, Economy, Federal, and the Singers entered into an agreement with Sinclair providing, in part, as follows:

> THIS AGREEMENT, made and entered into this 27th day of February, 1959, by and between Federal Oil Company, a New Jersey corporation, having its principal place of business at 525 Raymond Boulevard, Newark, N. J. Economy Service, Inc., a New Jersey corporation, having its principal place of business at 525 Raymond Boulevard, Newark, N. J., Federal Economy Corp., a New Jersey corporation, having its principal place of business at 525 Raymond Boulevard, Newark, N. J., parties of the first part, hereinafter collectively referred to as "Vendors"; Michael Singer, residing at 101 Central Park West, New York, and Sydel Singer, residing at 101 Central Park West, New York, New York, parties of the second part; and Sinclair Refining Company, a Maine corporation authorized to transact business in the State of New Jersey as a foreign corporation, having its principal business office at 600 Fifth Avenue, New York 20, New York, hereinafter called "Sinclair" party of the third part;

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WITNESSETH:

WHEREAS, Vendors are the owners of certain property in the City of Newark, New Jersey, hereinafter more particularly described, which they desire to sell to Sinclair and which Sinclair desires to purcase under the terms and conditions hereinafter set forth:

NOW, THEREFORE, in consideration of the mutual promises herein contained the parties hereto agree as follows:

1. Vendors agree to and do hereby sell, convey, assign, transfer and deliver to Sinclair all their right, title and interest in and to the good will and all right, title and interest in and to the names "Economy Service, Inc.", "Federal Economy Corp.", or any combination or variation thereof, including the word "Economy" used in connection with their retail fuel oil and oil burner service business and all their right, title and interest in and to their retail fuel oil and oil burner accounts and contracts.

2. Federal Oil Company agrees to and does hereby sell, convey, assign, transfer and deliver to Sinclair all its right, title and interest in and to the good will of Federal Oil Company as used in the retail fuel oil and oil burner service business and all its right, title and interest in and to its retail fuel oil and oil burner accounts and contracts, in Essex, Union, Hudson and Middlesex Counties, New Jersey.

3. Federal Oil Company agrees to and does hereby sell, convey, assign, transfer and deliver to Sinclair

all that certain piece or parcel of land, including all improvements situated thereon, more fully described in Schedule A attached hereto and made a part hereof. * * *

4. Economy Service, Inc., agrees to and does hereby sell, convey, assign, transfer and deliver to Sinclair all its furniture, signs, and tradefixtures on its books on the date hereof but not less than all items set forth in Schedule B, which is attached hereto and made a part hereof.

5. Federal Economy Corp. agrees to and does hereby sell, convey, assign, transfer and deliver to Sinclair all of its motor vehicle equipment, set forth in Schedule C, which is attached hereto and made a part hereof.

6. Economy Service, Inc., agrees to and does hereby sell, convey, assign, transfer and deliver to Sinclair all of its motor vehicle equipment set forth in Schedule D, which is attached hereto and made a part hereof.

7. Economy Service, Inc., agrees to and does hereby sell, convey, assign, transfer and deliver to Sinclair all its storehouse equipment and parts, including oil burners, furnaces, tanks, fittings, etc., to be determined by joint inventory of Economy Service, Inc., and Sinclair prior to the effective date of this Agreement; said inventory to be hereafter attached to this Agreement as Schedule E and to become a part hereof.

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8. Economy Service, Inc., agrees to and does hereby sell, convey, assign, transfer and deliver to Sinclair all of its stock of No. 2 fuel oil and kerosene to be determined by joint inventory of Economy Service, Inc., and Sinclair as of the effective date of this Agreement, said inventory to be hereafter attached to this Agreement as Schedule F and to become a part hereof.

• • •

10. Michael Singer and Sydel Singer, parties of the second part, individually and as officers, principal stockholders and employees of Vendors, jointly and severally, hereby covenant and agree with Sinclair that they will not, jointly or severally, at any time during the period of five (5) years from and after the effective date of this transfer, directly or indirectly, under any circumstances or conditions whatsoever, engage in or become interested individually or as a corporation, partnership, directors, officer, clerk, principal, agent, employee, trustee or in any relation or capacity whatever in the retail business, of selling or distributing fuel oil, and selling or distributing fuel oil burners and parts or the servicing of fuel oil burners within the Counties of Essex, Union, Hudson and Middlesex, without the written consent of Sinclair.

11. Federal Oil Company hereby covenants and agrees with Sinclair that it will not at any time during the period of five (5) years from and after the effective date of this transfer, directly or indirectly, under any circumstances or conditions

whatsoever, either singly or with any corporation, partnership or individual engage in the retail business, of selling or distributing fuel oil and of selling or distributing fuel oil burners and parts or the servicing of fuel oil burners within the Counties of Essex, Union, Hudson and Middlesex, New Jersey, without the written consent of Sinclair.

12. Economy Service, Inc., and Federal Economy Corp. agree that within ninety (90) days subsequent to the effective date herein provided each shall commence such action and proceedings as may be necessary for their respective legal dissolution or change of name and proceed to effect said dissolution or change of name as promptly as possible and that prior to their respective dissolution or change of name they shall abide by the covenants and obligations of Federal Oil Company set forth in the preceding paragraph.

Federal Oil Company hereby grants to Sinclair the right to use its name in connection with the accounts and contracts herein transferred for a period of ten (10) months from and after the effective date of this Agreement.

* * *

17. The consideration which Sinclair agrees to pay to Vendors for the transfers herein described and the time when same is payable shall be:

(a) To Federal Oil Company for the real property and improvements described in paragraph

3 and Schedule A hereof, the sum of Four Hundred and Eighty-five Thousand and 00/100 ($485,000.00) Dollars, payable on the effective date of this Agreement.

(b) To Economy Service, Inc., for the furniture, signs and trade fixtures described in paragraph 4 and Schedule B hereof, the sum of Eighty-five Thousand and 00/100 ($85,000.00) Dollars, payable upon the effective date hereof.

(c) To Federal Economy Corp. for its motor vehicle equipment described in paragraph 5 and Schedule C hereof, the sum of Sixty-two Thousand Five Hundred and 00/100 ($62,500.00) Dollars, payable upon the effective date hereof.

(d) To Economy Service, Inc., for its motor vehicle equipment described in paragraph 6 and Schedule D hereof, the sum of Seven Thousand Five Hundred and 00/100 ($7,500.00) Dollars, payable upon the effective date hereof.

(e) To Economy Service, Inc., for its storehouse equipment and parts described in paragraph 7 and Schedule E hereof, the actual value disclosed by the inventories thereof and as set forth in Schedule E, payable upon completion of said inventories and verification of said equipment and parts.

(f) To Economy Service, Inc., for its fuel oil and kerosene stocks described in paragraph 8 and

Schedule F hereof, the value based on New York harbor barge prices for said products, disclosed by the inventories thereof and as set forth in Schedule F, payable upon completion and verification of said inventories.

(g) To Economy Service, Inc., for the good will hereby acquired and all the right, title and interest of Economy Service, Inc., and Federal Economy Corp. in and to their respective names, the use of the name Federal Oil Company in connection with the retail fuel oil business mentioned in paragraph 2 and all right, title and interest in and to all of the retail fuel oil and oil burner service accounts as defined in paragraphs 1 and 2, the sum of Fifty Thousand and 00/100 ($50,000.00) Dollars, payable upon the effective date of this Agreement.

18. Sinclair agrees to pay to Federal Oil Company as and in consideration for its agreement to assist in retaining the retail fuel oil and oil burner service accounts and as consideration for its further agreement to refrain from engaging in the fuel oil, oil burner installation and service business as set forth above, the sum of Sixty-two Thousand and 00/100 ($62,000.00) Dollars per annum, commencing on the effective date of this Agreement, and a like amount of Sixty-two Thousand and 00/100 ($62,000.00) Dollars on the first day of March of each of the years 1960, 1961, 1962 and 1963.

19. The consideration for the agreement of second parties as set forth in paragraph 10 shall be the

benefit they derive as majority stockholders of Federal Oil Company.

The effective date of the transfer was March 1, 1959. On June 30, 1959, Economy and Federal were liquidated under section 332 of the Internal Revenue Code of 1954 and were dissolved pursuant to the requirement of paragraph 12 of the agreement.

During the five-year period from February 27, 1959, through February 27, 1964, covered by the agreement, neither petitioner nor the Singers engaged in the retail fuel oil, oil burner installation or service business. Beginning sometime in the summer of 1964, for a period of approximately three months, petitioner engaged in the retail fuel oil business under the management of someone other than Singer and reacquired some of Economy's customers which had been sold to Sinclair.

Retail fuel oil customers characteristically do not change suppliers as long as they receive good service, even if ownership changes as long as the transition is gradual. Of the retail accounts acquired by petitioner in 1952 and 1953 from Old Federal and City Coal, respectively, 90-95 percent were retained by petitioner and Economy and were on the books at the time of the sale to Sinclair. Petitioner did not notify these customers that they were being supplied by new proprietary interests. For a period of time after March 1, 1959, Sinclair used the trucks of petitioner and its subsidiaries for the conduct of the acquired retail fuel oil business. Sinclair also used Economy's billing system for a period after the closing of the agreement.

As a result of the agreement, Sinclair paid to petitioner $62,000 during March of 1959 through 1963. On its re-

turns for 1960 through 1963, petitioner treated the payments as long-term capital gain for the sale of goodwill, In his statutory notice of deficiency dated August 28, 1964, respondent determined that the payments are taxable as ordinary income because made for a covenant not to compete.

On its income tax returns for each of the taxable years 1959 through 1963, Sinclair deducted as an expense the $62,000 payment to petitioner, treating it as a payment for the covenant not to compete. Pending the outcome of this case, respondent has tentatively questioned Sinclair's treatment of the payments. The audit of Sinclair's returns for the years in question is presently being held in suspense pending further action.

The payments in the amount of $62,000 paid to petitioner in each of the years 1960, 1961 and 1962 by Sinclair were payments for a covenant not to compete.

OPINION

The sole issue is whether the payments in the amount of $62,000 made by Sinclair to petitioner in each of the years 1960, 1961 and 1962 pursuant to the agreement of February 27, 1959, were consideration for petitioner's covenant not to compete, taxable as ordinary income, or payment for goodwill, taxable as capital gain.

The agreement of February 27, 1959, whereby petitioner's fuel oil business was sold to Sinclair, specifically sets out a covenant on the part of petitioner not to engage in the fuel oil business for a period of five years without Sinclair's consent and provides a consideration for this covenant in the amount of $62,000 annually over the life of the agreement. Petitioner asks the Court to disregard the

written agreement of the parties and find that the $310,000 total consideration assigned to the covenant not to compete was in reality a payment for goodwill. In the alternative, petitioner contends that the amount of $21,000 was paid for the noncompete agreement and that the remainder of the consideration stated therefor was payment for goodwill.

It is true that the Court is not bound by the form in which parties to an agreement clothe their transaction but is charged with the duty of determining the realities of the transaction after having considered all the pertinent facts. *Carl L. Danielson,* 44 T. C. 549, relied upon by petitioner, and cases cited therein. Nonetheless, where the parties have specifically set out a covenant not to compete in an agreement and have assigned a value to the covenant, strong proof is required to prove that the agreement differed in reality from the written expression thereof. *Ullman* v. *Commissioner,* 264 F. 2d 305 (C. A. 2), affirming 29 T. C. 129; *Hamlin's Trust* v. *Commissioner,* 209 F. 2d 761 (C. A. 10), affirming 19 T. C. 718; *Benjamin* v. *Levinson,* 45 T. C. 380. The burden of so proving lies with the petitioner. *Ullman* v. *Commissioner, supra.*

In the instant case, the covenant not to compete was a subject of negotiation from the earliest discussions which resulted in the agreement of sale between Sinclair and petitioner, its wholly-owned subsidiaries, and the Singers. Sinclair consistently insisted upon a noncompete agreement and the allocation of a substantial portion of the purchase price to the covenant. During the course of the negotiations Sinclair's tax manager explained to Singer, who represented petitioner in the negotiations, that that portion of the purchase price allocated to the covenant not to compete would be taxable to petitioner as ordinary income.

Appendix C

Edward J. Anglin, assistant to the financial vice president of Sinclair's parent corporation, Sinclair Oil, having the duty of reviewing all capital expenditures and making recommendations to the financial vice president, testified that in his opinion Sinclair would not have entered into the agreement if less than $310,000 of the purchase price had been allocated to the covenant. Singer never objected to the inclusion of the noncompete agreement or the allocation of $310,000 of the purchase price to the covenant and signed the agreement on behalf of petitioner after receiving a copy of the final draft of the contract prior to the execution date.

Where, as here, the taxpayer enters into an agreement which has been the subject of arm's-length negotiations, freely, willingly and knowingly, we are not inclined to rewrite the agreement into one which the parties themselves would not have transacted. See *Benjamin Levinson, supra.* The fact that tax considerations admittedly played a part in determining the amount of the purchase price allocated to a covenant not to compete does not contaminate the transaction as long as the covenant was seprately bargained for and has some independent basis in fact or arguable relationship with business reality. *Schulz* v. *Commissioner,* 294 F. 2d 52 (C. A. 9), affirming 34 T. C. 235; *Benjamin Levinson, supra; Carl L. Danielson, supra.*

In the instant case, petitioner entered the retail fuel oil business in 1952. By 1956 it had acquired the assets of three corporations previously engaged in the retail fuel oil business and in that year transferred its retail business to Economy, its wholly-owned subsidiary, which by 1959 was doing a business of approximately 12 million gallons annually. Singer, who owned 66⅔ percent of petitioner's stock and directed the business policies of petitioner, Economy,

and Federal, was 56 years of age in 1959 and in good health. Singer's acumen as a businessman is well illustrated by the rapidity with which petitioner, and then Economy, developed a substantial fuel oil business. The fact that petitioner could have been a real competitive threat to Sinclair cannot be doubted. In fact, after the five-year term of the covenant, petitioner did engage in the retail fuel oil business, under the management of someone other than Singer, and reacquired some of Economy's customers which had been sold to Sinclair.

Petitioner's covenant not to compete which was included in the February 27, 1959, agreement with Sinclair and the consideration payable therefor were the subject of separate negotiations in an arm's-length transaction. Unlike the *Danielson* case, where a portion of the purchase price was without prior notification or discussion, the written agreement in the instant case realistically reflects the negotia- allocated to the noncompete agreement at the last minute tions of the parties. This is our only concern where, as here, the noncompete agreement has some arguable relationship with business reality. Cf. *Bathrope* v. *Commissioner*, 356 F. 2d 28 (C. A. 5), affirming a Memorandum Opinion of this Court.

Respondent's determination that the $62,000 paid by Sinclair to petitioner in each of the years 1960, 1961 and 1962 was payment for petitioner's agreement not to compete and taxable as ordinary income is sustained.

Decision will be entered for the respondent.

APPENDIX D

Order Extending Time to File Petition for Writ of Certiorari

SUPREME COURT OF THE UNITED STATES
No. ———, October Term, 1967

———♦———

Federal Oil Company,

Petitioner,

vs.

Commissioner of Internal Revenue

———♦———

Upon Consideration of the application of counsel for petitioner,

It Is Ordered that the time for filing a petition for writ of certiorari in the above-entitled cause be, and the same is hereby, extended to and including January 12, 1968.

/s/ William J. Brennan, Jr.
Associate Justice of the Supreme
Court of the United States

Dated this 21 day of December, 1967.